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SUBJECT: LOWER THIRD QUARTER GROWTH BUT MORE TIGHTENING
LIKELY

SUMMARY

1. (SBU) China's year-on-year GDP growth rate, as measured on a quarterly basis, fell from 11.3 percent in the second quarter to 10.4 percent in the third quarter, a result in line with numerous private sector forecasts. The decline comes in the wake of numerous cooling measures undertaken by the Central Government in recent months, including hikes in interest rates and the reserve requirement as well as administrative measures targeting specific sectors such as housing and steel. Economic policy makers appear set to interpret the third quarter result as a sign that recent efforts to slow the economy are working but should continue.
END SUMMARY.

FALL IN THE GDP GROWTH RATE

2. (U) National Bureau of Statistics (NBS) figures released on October 19:

GDP Growth Rate (percent, year-on-year)

2005 (Full Year)	10.2	
2006 (YTD)	10.7	* released October 19
-- 1Q	10.3	
-- 2Q	11.3	
-- 3Q	10.4	* released October 19

3. (U) The third quarter result, in line with private sector forecasts, still indicates a growth rate above that recorded in 2005. The recent downtrend on a quarterly basis, however, is significant because it suggests that recent efforts to cool China's economy may be having some effect. Measures employed in recent months have included two interest rate hikes of 27 basis points each, a rise in bank reserve requirements, and a range of administrative actions aimed at cooling lending and activity in sectors such as housing and steel.

4. (U) NBS statistics also show continued low inflation, with a 1.3 percent year-to-date rate of increase in general consumer prices.

OTHER SIGNS OF COOLING

15. (U) Other recent data show further signs of cooling:

o The widely watched urban fixed asset investment (FAI) growth rate is on a downward trend over recent months:

2006 Urban Fixed Asset Growth
(percent, year-on-year)

June	34.0
July	27.0
August	21.5
September	23.6

o The money supply (M2) grew at 16.8 percent in September, its slowest pace in 14 months.

o Value added industrial output growth fell to 15.7 percent in September from 19.5 percent in August.

REACTION

16. (SBU) Reacting to the growth figures, NBS Spokesman Li Xiaochao, in a released statement, trumpeted "the good momentum of steady and fast growth" but referenced a continued need to enhance "the achievements brought by macro-regulatory control." Chinese Academy of Social Sciences Senior Research Fellow Wang Tongshan, who provides input to government officials on economic policy issues, told us October 19 that the lower GDP growth rate suggests the government's macroeconomic tightening measures are showing results. He said that there is still too much investment and

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excess liquidity in the economy and predicted sustained cooling efforts over the next six months.

COMMENT

17. (SBU) There may be a cooling trend, but the data supporting it are still young. Some private economists have pointed out contrary indicators in recent weeks, such as higher growth rates in power consumption, cement production, and freight traffic. Consequently, several more months may be needed to conclude whether recent efforts to calm the economy have been successful and also whether they have staying power.
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